By Bruce Edwards

Vermont's congressional delegation is once again taking aim at Wall Street speculators as a major culprit in driving up prices at the pump — prices that are likely to spike well above $4 a gallon this summer.

But casting investment banks and hedge funds as the sole villains isn't so black and white, said two oil industry analysts, who point out that geopolitical and industry factors also come into play.

Sens. Bernard Sanders and Patrick Leahy, along with Rep. Peter Welch, were among 68 Senate and House members who put their signatures on a letter last week urging the Commodities Future Trading Commission to put in place rules to curb excessive speculation.

The Dodd-Frank Wall Street Reform and Consumer Protection Act that was signed into law two years ago mandated that the five-member Commodities Future Trading Commission come up with rules that rein in excessive speculation in the futures market, including energy futures.

The strongly worded letter takes the commission to task for failing to meet its Jan. 17, 2011 deadline to enforce that mandate.

"As the cost for American people to fill their gas tanks continues to skyrocket, the CFTC continues to drag its feet on imposing strict speculation limits to eliminate, prevent, or diminish excessive oil speculation as required by the Dodd-Frank Act," read the March 5 letter. "Although the CFTC has adopted initial position limits, they are not strong enough and not yet in force owing to industry opposition, delays in swaps oversight and data collection. This is simply unacceptable and must change."

Supply and demand?

The effort to pressure the CFTC was led by Sanders, an independent, who pointed to a recent article in Forbes as evidence speculation is a prime culprit in soaring oil prices. The article cited a report from Goldman Sachs that excessive speculation adds 56 cents a gallon to the price of gasoline.

Sanders said in an interview that 80 percent of the futures market is now controlled by speculators and not end users like airlines, heating oil or trucking companies.

"Their job in life is not to use the product but buy and sell it, drive prices up," Sanders said, referring to Goldman Sachs.

The letter to the CFTC said the current price of gasoline, (which is approaching $4 a gallon in Vermont), is not based solely on the law of supply and demand.

The letter noted that there is a more plentiful supply of oil and gasoline today than there was three years ago when gasoline was $1.90 a gallon. At the same time, "demand for oil is at its lowest levels since April of 1997."

The price of gasoline and other fuel products plummeted three years ago following the worldwide financial collapse – considered the worst economic crisis since the Great Depression.

Late last week, the cheapest gas in the state was $3.65 a gallon at an Irving store in Winooski. The most expensive gas was $3.99 a gallon at the Shell station in Killington, according to VermontGasPrices.com.

Rules in waiting

The Commission adopted final rules in October to curb excessive speculation and price manipulation in 28 commodities, including agriculture and energy, with the limits put in place in two phases: for the spot month and nonspot month.

The spot month is the closest month following a purchase or trade when a commodity can be delivered. Nonspot months are all contract months combined or future deliveries contained in a single contract month.

But those limits are being held up while the CFTC and the Securities and Exchange Commission agree on a definition of "swaps," which has been an integral part of the commodities market but one that has been done in "the dark" with no oversight. The CFTC estimates that the swaps market is seven to eight times larger than the futures market.

In general terms, a swap is arranged to hedge against the price of a commodity, usually oil.

"They came up with some weak regulations but haven't put them in place because they still want more data," Sanders said. "They are a year behind where they should have been and what this letter says to them is get your act together."

In an email, Leahy, too, said the CFTC needs to move more expeditiously.

"Oil price speculation is part of the dynamic pressure that has been pumping up fuel prices. It is not the only cause, but CFTC needs to move more urgently to develop the tools Congress has authorized to limit abuses," Leahy said.

Commenting on the delay, Commission spokesman David Gary said when Congress passed Dodd-Frank it failed to recognize the work involved in putting the rules in place.

"In order to establish a meaningful position limit, you have to take into consideration all markets in which specific contracts or contracts in kind are traded," Gary said. "And if you put on position limits that aren't totally reflective of what's playing out in futures markets, options markets and the swaps markets, you're going to get an imbalance ... if there are no limits in the swaps market, they're going to trade in the swaps market."

If that were to happen, Gary said it would damage the futures markets by putting in place unrealistic position limits.

Double-edge sword

Tom Kloza, chief analyst with the Oil Price Information Service, said involvement in the market by the likes of Goldman Sachs cuts both ways.

"Most of the day-to-day action is conducted by investment banks, hedge funds, and paper traders. To the extent that money managers, like Goldman Sachs, bet on higher prices, one can say that it helps prices reach levels that encourage investment, innovation, technological improvements, etc.," Kloza said in an email. "There is nothing collusive about the actions of the big money managers or banks, but it can have a damaging impact for people on the margins of society who live paycheck to paycheck."

Based in Gaithersburg, Md., the Oil Price Information Service (www.opisnet.com) is predicting that gasoline will peak between $4 and $4.25 a gallon nationally with the caveat that a number of states will set record prices breaking the July 2008 records in most cases.

The U.S. Energy Information Administration forecast is a bit more conservative, estimating an average price this summer (between April and September) of $3.92 a gallon with a May peak averaging $3.96 a gallon.

Helping to drive up prices, Kloza said are some of the usual suspects: turmoil in the Middle East, combined with U.S. refinery maintenance and the closure of at least two major East Coast refineries and several refineries in Europe.

"The outlook short term is for higher prices. The big money managers have anticipated March and April problems for global crude and U.S. gasoline and to some extent they have already 'priced in some of the troubles.'" Kloza said. "This is why we see a huge speculative bias in gasoline futures, for example. There has never been this money 'wagered' on higher gasoline prices. The financial money is also largely on the buy side of crude oil as well."

To Michael Lynch, pointing a finger at Wall Street speculators is a typical case of needing someone to blame. "The thing is there are things going on now that are driving up the price of oil," said Lynch, an analyst with Strategic Energy & Economic Research (www.energyseer.com) in Winfield, Mass.

Lynch has heard the argument that the likes of Goldman Sachs buy up futures contracts, driving up prices, with no intention of ever taking delivery.

"You can say they are not using it but they do serve a useful purpose in the sense they help move the price in a relatively efficient way," he said.

Lynch said the country faced a similar problem in the agricultural sector with caverns of surplus cheese because the government said the price was too low.

"It's an imperfect system but it's a lot better than anyone has ever tried," he said.

Lynch said that's not to say the commodity market shouldn't be regulated or that more transparency isn't needed.

According to OPIS, consumers in the U.S. spent $481.3 billion on gasoline last year, breaking the previous record of $448 billion in 2008.

Over the past 20 years, the average price of a gallon of gas has more than doubled, from $1.50 a gallon in 2000 to $3.51 last year.

Factor in politics

Welch, a vocal critic of Wall Street speculators, said politics has played no small part in delaying the overall implementation of Dodd-Frank.

He said Republicans in the House have attempted to gut the law, including cutting the budget for the CFTC.

"So, the CFTC is understaffed to do its job, when the demands on it are greater," Welch said.

Although Democrats have a 3-2 advantage on the Commission, he said partisan conflict exists, slowing down the process.

"(It's) the kind of partisan deadlock that's been afflicting productivity in Washington to the detriment of the economy," Welch said.

To free the CFTC from partisan budget battles, Welch has proposed self-funding the commission through a small user fee on financial transactions as opposed to the current congressional budget appropriation.

Welch is also pushing a reluctant Obama administration to release oil from the Strategic Petroleum Reserve. He said history shows that when oil has been released from the SPR, oil prices have dropped for a time helping to curb excessive speculation in the futures market.

"Each time it's been used it's reduced the price at the pump ... 8 percent the last time President Obama did it around Libya and 33 percent when the first President Bush did it," Welch said.

Kloza of the OPIS said while a sale from the SPR is unlikely, that shouldn't stop Obama from raising the prospect.

"The Obama administration should probably continue to 'talk up' the notion of coordinated international sales of crude," Kloza said, "if only to put some fear of downside risk into the minds of speculators who believe there is no risk in betting on higher prices. But that said, an SPR sale that would have an impact, is probably a long shot."